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IN THE  
**United States Court of Appeals**

NINTH CIRCUIT

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No. 16,823  
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ESTATE OF WALTER F. RAU, SR., Deceased, Raymond J.  
Shorb, Administrator With the Will Annexed, *Petitioner*,

VS.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

\_\_\_\_\_  
Petition for Review of Decision of the Tax Court  
of the United States  
\_\_\_\_\_

**BRIEF FOR PETITIONER**

\_\_\_\_\_  
ELLSWORTH T. SIMPSON  
*Attorney for Petitioner on Review*  
1029-33 Investment Building  
Washington 5, D. C.

*Of Counsel:*

THOMAS H. WERDEL, *Esquire*  
Bakersfield, California

**FILED**



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**Petition for Review of Decision of the Tax Court  
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**BRIEF FOR PETITIONER**

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**JURISDICTIONAL STATEMENT**

On the 17th day of January, 1956, the Commissioner of Internal Revenue mailed to Petitioner on Review a Statutory Notice of Deficiency proposing deficiencies in income taxes and the ad valorem penalty for each of the years 1942

through 1947 inclusive. The Petitioner's Decedent was a resident of Bakersfield, Kern County, State of California and filed individual income tax returns with the District Director at Los Angeles, California. On the 20th day of March 1956, a Petition was filed with the Tax Court of the United States seeking a redetermination of the deficiencies proposed for each of the years in question; on the 25th day of September 1959, the Tax Court of the United States entered its decision after hearing the case on its merits at Los Angeles, California.

On the 23rd day of December 1959, and pursuant to Sections 7482 and 7483, Internal Revenue Code, 1954, Petitioner filed a Petition for Review to the United States Court of Appeals for the Ninth Circuit; jurisdiction was vested in the Tax Court of the United States as provided in Section 7442, Internal Revenue Code, 1954. This Court has jurisdiction to review these proceedings by virtue of the provisions contained in Section 7482, Internal Revenue Code, 1954.

### STATEMENT OF THE CASE

This is a petition to review the decision of the Tax Court of the United States entered September 25, 1959, ordering and deciding that there are deficiencies in Petitioner's Decedent's income taxes, and additions to the tax, for the years 1942 to 1947 inclusive as set forth below:

Year	Kind of Tax	Deficiency	Additions to Tax Sec. 293(b) I.R.C. 1939
1942	Income .....	\$ 5,901.47	\$ 2,778.22
1943	Income and Victory .....	52,913.50	33,454.19
1944	Income .....	53,725.33	28,728.08
1945	Income .....	46,292.81	23,146.41
1946	Income .....	12,303.72	6,151.86
1947	Income .....	17,214.11	8,607.06

## QUESTIONS INVOLVED

The questions involved, and the manner in which they were raised in this proceeding, may be summarized as follows:

1. Question of the survival of the fraud penalty imposed subsequent to the death of Petitioner's Decedent; although it was not argued on brief by Petitioner, this issue was pleaded generally in the petition filed with the Tax Court of the United States (R. 6, 7, 8). On brief, Petitioner noted this issue but deferred argument thereon for the reason that the decisions of the Tax Court were unfavorable to Petitioner on this issue; accordingly, Petitioner reserves argument on appeal with respect thereto.

2. The question of the proper method of determining the income of Petitioner's Decedent for each of the years under review; this issue was raised during the hearing in conjunction with stipulations filed with the Court below whereby the parties to this proceeding agreed upon the net worth of the Decedent for each of the years 1942 to 1947 inclusive. Specifically, Petitioner urged the adoption of the net worth method for making such determination under the circumstances prevailing herein. The question of accepting oral testimony of two former employees as constituting "specific items" for reconstructing Decedent's income is an integral part of this question. During the hearing, and on brief, Petitioner opposed the acceptance of such oral testimony on the grounds that it did not constitute an acceptable "method" warranting the rejection of the net worth method; this aspect has been assigned as one of the errors on appeal (R. 91).

3. The question of liability of Petitioner's Decedent for the fifty per cent fraud penalty asserted by Respondent on Review, and sustained by the Court below, for each of the years 1942 to 1947 inclusive; involved in this question is the burden of proof imposed upon Respondent under the

provisions of Section 1112, Internal Revenue Code, 1939; incorporated in this question is the issue of whether or not the Respondent has met such burden by "clear and convincing" evidence under all of the facts and circumstances existing herein. Initially, this issue was raised by Petitioner on Review in its petition filed with the Court below under date of March 20, 1956 (R. 6, 7, 8); it has also been raised in the petition for review (R. 90).

4. The question of the correctness of the liability of Petitioner's Decedent for income taxes as determined by the Court below; this question was raised by Petitioner during the hearing and on brief and represents one of the errors assigned on appeal (R. 91).

#### **SPECIFICATION OF ERRORS**

1. The Tax Court erred in deciding that the fifty per cent (50%) fraud penalty survived the death of Petitioner's Decedent.

2. The Tax Court erred in deciding that the Petitioner on Review was liable for the fifty per cent fraud penalty, (Section 293(b), I.R.C. 1939) for each of the years involved herein.

3. The Tax Court erred in deciding that the statute of limitations was not a bar to the assessment and collection of taxes for the years 1942 through 1944, inclusive.

4. The Tax Court erred in that its decision is not supported by the evidence and is contrary to law.

5. The Tax Court erred in rejecting the net worth method, and, by substituting therefor, the uncorroborated testimony of two employees in determining the income tax liabilities of the Decedent for each of the years in question.



**SUMMARY OF ARGUMENT**

1. The fifty per cent (50%) fraud penalty asserted by the Commissioner of Internal Revenue subsequent to the death of Petitioner's Decedent, pursuant to the provisions of Section 293(b), Internal Revenue Code, 1939, should not survive Decedent's death.

2. In the absence of adequate books and records, the net worth method represents the most reliable means for determining taxable income of Petitioner's Decedent for the years 1942 to 1947 inclusive.

3. Uncorroborated oral testimony, of former employees, does not constitute "specific items", or "specific adjustments", within the ordinary meaning of such phrase.

(a) The stipulation between the parties, as to the net worth of Petitioner's Decedent for the years 1942 to 1947 inclusive, precludes an attack on such net worth in the absence of proof of discrepancies or duplications therein; facts stipulated between the parties are judicial admissions and require no substantiation.

4. The amount by which the Court below increased the income of Petitioner's Decedent over that resulting from the net worth method, is not, in fact, income taxable to Petitioner's Decedent.

5. The evidence presented to the Court below is legally and factually incapable of supporting the allegation of fraud.

(a) in its opinion, the Court below conceded that the testimony of Respondent's witnesses contained minor discrepancies; without comment, the materiality thereof was disposed of by the Court by stating that no useful purpose would be served in reviewing the evidence; thus, a mixed question of law and fact is raised on appeal.

## ARGUMENT

### PART I. SURVIVAL OF FRAUD PENALTY

It is well established, of course, that, at common law, death abates actions to recover for a wrong-doing. In the absence of specific statutory authority to the contrary, such principle should obtain; applying this basic concept to the question involving the survival of the civil fraud penalty in income tax matters, it is necessary to consider the language of Section 293(b), Internal Revenue Code, 1939; Section 293, I.R.C. 1939, is identified as "Additions to Tax in Case of Deficiency"; Section 293(b) thereof provides as follows: "If any part of any deficiency is due to fraud with intent to evade tax, then fifty per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected and paid in lieu of the fifty per centum addition to the tax provided in Section 3612(d)(2)." The language of that section does not, by implication or otherwise, specifically authorize the collection of any addition due to fraud when such deficiency is not determined until subsequent to the taxpayers' death; lacking such express authorization, the construction of Section 293(b), I.R.C., 1939, should, under recognized principles relating to construction of tax statutes, be construed in favor of the taxpayer.

Notwithstanding the fact that the Legislature employed the words "addition to the tax", it is equally clear that such additions were to be assessed and collected in the event of fraud; fraud itself connotes evil intent and wrong-doing and this, coupled with the amount of such addition, makes it more apparent that such "addition" was intended as a penalty for such wrong-doing. The mere use of such language does not alter the very nature of that which is assessed, collected or paid; to ignore the substantive aspects of this matter is to indulge in sophistry at the expense of logic and reason.

Although this question has been presented to the Tax Court in numerous cases, over a period of many years, it was not until the decision of the Tax Court in *Estate of Louis L. Briden, Deceased*, 11 T.C. 1095, that this question was resolved against the taxpayer. Prior to that time the decisions of the Tax Court, District Courts and Courts of Appeal uniformly held that fraud abated upon the death of the taxpayer. *Thome v. Lynch*, United States District Court, Minn., decided February 17, 1921; *U. S. v. Theurer, et al*, 215 Fed. 964, C. C. A. 5th (1914); *Wickham v. Commissioner of Internal Revenue*, 65 Fed. 2d. 527, 12 AFTR 820, C. C. A. 8th (1933); *National City Bank of New York, Executors v. Commissioner of Internal Revenue*, 35 B. T. A. 975 (1937).

In *Estate of Louis L. Briden, supra*, the Tax Court adopted the decision of the Supreme Court of the United States in *Helvering v. Mitchell*, 303 U. S. 391, in concluding that the fraud penalty survived the death of the taxpayer; it is significant to note that the question of the survival of the fraud penalty was never mentioned by the Supreme Court in *Helvering v. Mitchell, supra*; in fact, the Supreme Court confined its opinion to the distinction between civil and criminal sanctions; the word "sanction" is used repeatedly and, as defined in a desk dictionary in everyday use, a "sanction" is a penalty or punishment. In *Helvering v. Mitchell, supra*, the Petitioner contended that an acquittal for criminal tax evasion precluded the assertion of the fifty per cent civil fraud penalty in civil proceedings before the Tax Court of the United States; speaking for the Supreme Court of the United States, Justice Brandeis noted that the Revenue Act of 1928 provided for two separate and distinct provisions imposing sanctions, namely Section 145(b) and Section 293(b) of the Revenue Act; when this question was presented to the Circuit Court of Appeals for the Second Circuit, Justice Learned Hand held that the decision of the Supreme Court in *Coffey v. U. S.*, 116 U. S.

436, precluded the assessment of the fifty per cent penalty after an acquittal in criminal proceedings. Not only did the Tax Court, in *Estate of Louis L. Briden, supra*, adopt the decision in *Helvering v. Mitchell, supra*, in reaching its conclusion that the fraud penalty did not abate upon the death of the decedent, it went further; without discussing basic concepts, it found that the fifty per cent addition to the tax was not, in fact, a penalty and seized upon the word "addition" in so doing; a penalty involves the idea of punishment. *U. S. v. Reisinger*, 128 U. S. 398; *Huntington v. Attrill*, 146 U. S. 657; the character of the penalty is not changed by the mode in which it is inflicted, whether by suit or by criminal prosecution. *U. S. v. Chouteau*, 102 U. S. 603, 611.

When the question of the survival of the fraud penalty was presented again to the Circuit Court of Appeals for the Second Circuit, it affirmed the decision of the Tax Court on that issue. *Scadron's Estate*, 212 Fed. 2d 188, T. C. Memo Decision, 1953; the Second Circuit adopted the opinion of the Supreme Court in *Helvering v. Mitchell, supra*, as did the Tax Court in *Estate of Louis L. Briden, supra*; in so doing, however, the Second Circuit observed that if the question had been *res integra*, it might have reached a different conclusion; reference was made to the construction placed upon Section 293(b), I.R.C. 1939, by the Supreme Court in the *Mitchell* case in which it was said that the language of that section was not to be considered as penal in any sense; inasmuch as the Supreme Court was distinguishing between the character of Section 145(b) and that of Section 293(b) with respect to the degree of proof required, and not as to the survival of the penalty, the question, in fact, was *res integra* and the Circuit Court of Appeals for the Second Circuit overlooked an opportunity to meet this issue directly.

In summary, the present status on the question of the survival of the fifty per cent penalty leaves something to be

desired in the way of clarity of thought; until Congress of the United States enacts specific legislation providing for the survival of this penalty, it should abate upon the death of the taxpayer. This position is supported when consideration is given to other causes of action involving civil actions for damages instituted by or on behalf of the United States; in this regard, reference is made to Title 28, Section 2404, U. S. Code, relating to death of Defendant in damage action; that section provides as follows:

“A civil action for damages commenced by or on behalf of the United States or in which it is interested shall not abate on the death of a defendant but shall survive and be enforceable against his estate as well as against surviving defendants.” June 25, 1948.

Thus, it is quite obvious that Congress found it necessary to enact specific legislation in order to prevent the application of common law principles in civil actions for *damages*.

## **PART II. NET WORTH METHOD MOST RELIABLE FOR DETERMINING TAXABLE INCOME**

The information reflected in the Decedent's net worth for the years 1942 through 1947 inclusive was obtained from various third party sources and was subjected to critical examination by Respondent prior to the stipulation thereof (Appendix pages 41-42); the absence of documentary evidence revealing errors and duplications in the net worth statement deserves more than token consideration; this fact, alone, serves to impugn and contradict the testimony of Respondent's witnesses. It might well be argued that Respondent should have substantiated the testimony of its own witnesses in increasing Decedent's income in excess of that resulting from the net worth method rather than representing to the Court below that such testimony was employed for the purposes of substantiating Decedent's net worth (R. 226).

In support of its rejection of the net worth method in determining Decedent's taxable income, the Court below cited the case of *Emilie Furnish Funk v. Commissioner of Internal Revenue*, 29 T. C. 279, 299-293; Aff'd. 262 Fed. 2d. 727, C. A. 9; a review of that decision reveals a marked dissimilarity in the facts in that case with those involved in the instant proceeding. In *Funk v. Commissioner, supra*, the Petitioner engaged an auditor to examine the records maintained by the Petitioner, a physician, in the course of his medical practice; these records, patient cards, reflected the fees received by the Petitioner and constituted documentary evidence of his income; these records, therefore, constituted specific items of income as prepared by the Petitioner himself and the necessity of employing a different method of determining his income was nonexistent. Petitioner has no quarrel with the decision in the Funk case but opposes the application thereof to the facts in the case under review. In the Funk case, there were omissions and duplications in the net worth statement and there was no showing that such net worth was a part of the stipulations between the parties; the actual receipt of the monies taxed to the Petitioner in the Funk case was established by his own records and did not rest upon oral testimony for substantiation.

In *Funk v. Commissioner, supra*, the "specific items" were substantiated by actual documentary proof, whereas, the so-called "specific items" (oral testimony) in the present case lacked comparable substantiation; to illustrate, it may be assumed that income was actually withheld, as claimed by Respondent, and yet there is no evidence of any kind establishing that these receipts were not deposited in Decedent's several bank accounts; in other words, the withholding of receipts, standing alone, does not prove that such receipts were not deposited in the Decedent's bank accounts. The question of cash on hand is not involved in the present case and we are not here confronted with any self-serving declaration relative to the net worth statement

as was the situation in the Funk case; not one dollar of income, in excess of Decedent's net worth, has been traced to the possession of Decedent other than the funds on deposit in his bank accounts. The Decedent did not use conduits or agents in reporting his income and the funds attributed to the Decedent in excess of his net worth are singularly related, in amounts, to the funds deposited by his two employees in their personal bank accounts. In the Funk case, the Petitioner was a well educated physician and there was no evidence that he was addicted to the excessive use of alcohol; there was no showing that he entrusted the operation of his profession to employees; there was no evidence in the Funk case indicating that Petitioner's employees conducted private financial transactions in amounts far in excess of their known income. In an effort to account for the income in excess of Decedent's net worth, Petitioner was faced with the onerous task of ferreting out the private financial affairs of Respondent's witnesses. The whereabouts of such enormous funds, over and above Decedent's net worth was unknown; therefore, Petitioner endeavored to discover the location and final disposition of such funds. Although Petitioner succeeded in tracing substantial sums to the personal bank accounts of Respondent's witnesses, it lacked the authority to compel them (Webb and Goldstein) to disclose the contents of their safe deposit boxes; on the other hand, it is a relatively easy task for Respondent to obtain such information and, under the circumstances, it is submitted that Respondent had the duty of removing the "smoke" which the Court below said that Petitioner generated in this regard (R. 256).

It is well to review the findings of the Court below relative to its determination of taxable income; having rejected the net worth, and having accepted the testimony of Webb and Goldstein as "specific items", the total tax liability of Decedent, including the amounts previously paid, for the years 1942 through 1947 inclusive, according to the Tax Court, aggregates the sum of approximately \$330,000.00,

exclusive of the fifty per cent penalty; the net increase in Decedent's net worth for this period was \$184,000.00 as compared with the sum of \$187,000.00 in additional income taxes as determined by the Court below. In addition to accepting the so-called "specific items", of withheld income, the Court below further increased Decedent's income to the extent of alleged overstatement of purchases for the years 1943 to 1946 inclusive as claimed by Respondent in its Amendment to Answer (R. 41, 42); in its reply to Respondent's Amendment to Answer, Petitioner resisted this increase on the grounds that the Statutory Notice of Deficiency already reflected such alleged overstatements and that any further allowance would result in a duplication of income (R. 43, 44, 45); without a hearing on this issue, the Court below accepted Respondent's determination. The findings of the Tax Court as to the amount of the deficiency may be more graphically illustrated in the following tabulation:

Additional Net Income	1942	1943	1944	1945	1946	19
Per Tax Court	29,935.00	83,466.89	62,768.07	31,214.14	11,675.81	12,977
Net Worth Basis	3,907.18	7,524.89	40,204.47	57,395.08	(6,458.50)	(1,711)
<hr/>						
Net Increase Over Net Worth	26,027.82	75,942.00	22,563.60	(26,180.94)	18,134.31	14,723
Total Additional Income Per Tax Court Findings .....						\$232,031
Total Additional Income Per Net Worth Method .....						100,811
Total Increase Over Net Worth Per Tax Court Findings .....						<u>131,211</u>
<hr/>						
	1942	1943	1944	1945	1946	194
Tax Liability Per Tax Court	5,901.47	52,913.50	53,725.33	46,292.81	12,303.72	17,214
Taxes Paid	690.09	6,254.03	6,995.32	27,638.93	51,708.95	50,171
Difference	5,211.38	46,659.47	46,730.01	18,653.88	(39,405.23)	(32,957)
Total Tax Deficiency Per Tax Court				\$188,350.94		
Total Taxes Paid				<u>\$143,458.99</u>		
Total Liability				\$331,809.93		



By accepting the Tax Court's determination, one is compelled to accept the proposition that Petitioner's Decedent was in possession of approximately \$131,000.00 at the end of 1947, a fact which has never been substantiated by any evidence whatsoever.

Viewing this situation realistically, it is not unreasonable to characterize such a result as the product of imagination. Not only is the decision of the Tax Court lacking in realism, its findings are predicated upon surmise and conjecture; specifically, by accepting the testimony of Webb and Goldstein as "specific items", the Court below has, in effect, surmised that the so-called "withheld receipts" were not deposited in any of the Decedent's bank accounts; there is no evidence in the record that such receipts were not so deposited. The Court below made its determination notwithstanding the fact that the balances in Decedent's bank accounts totalled \$87,471.89 as of December 31, 1947; included in this figure is the sum of \$22,000.00 representing Decedent's cash contribution to a partnership venture by withdrawing funds from his bank account.

In summarizing this aspect of the finding of the Court below, it should be noted that no consideration has been accorded the possibility that the so-called "withheld receipts" might have been used in acquiring assets; the reasonableness of this hypothesis deserves greater weight than the conclusion of the Tax Court that Decedent was in possession of at least \$131,000.00 at the end of 1947. It is most significant to observe that, in the final analysis, the testimony of Webb and Goldstein does not conclusively establish that the withheld receipts were not, in fact, deposited in Decedent's bank accounts; nor, indeed, does such testimony preclude the possibility that the withheld receipts were used in the acquisition of assets. The substance of their testimony is that receipts were withheld and neither of these witnesses mentioned or attempted to account for the ultimate disposition of the withheld receipts. It is submitted,

therefore, that the finding of the Court below as to the deficiencies for each of the years in question is clearly erroneous and is not supported by the evidence.

**PART III. UNCORROBORATED ORAL TESTIMONY DOES NOT CONSTITUTE "SPECIFIC ITEMS"**

Heretofore, unsubstantiated oral testimony has not served as an acceptable basis for determining the income tax liabilities of a taxpayer; nor has it received prior judicial approval in ascertaining deficiencies against an Estate where, under ordinary circumstances, an abundance of caution is essential in safeguarding the rights of a Decedent's Estate. The duty of protecting the revenue should not be exercised in derogation of these rights. Historically, Courts have always scrutinized claims against an Estate with utmost care; claims for additional taxes and penalties should not be regarded as an exception; in representing an Estate, the representatives are obliged to perform their duties without the benefit of any assistance from the Decedent. It is obvious, therefore, that the representatives must conduct the affairs of the Decedent under a handicap with which Respondent is not burdened. Notwithstanding these well recognized principles, the Court below approved and accepted, without exception, Respondent's method in determining the deficiencies in income taxes in the case under review.

Within the ordinary meaning of "specific items", the items themselves must be definite or ascertainable; they must be identifiable as by a record or document and should not, of course, depend upon oral testimony alone. In the instant case, all of Decedent's records were not available and could not, therefore, be offered in evidence. Despite this, however, the Court below has classified such unsubstantiated oral testimony as, "specific items"; the entries appearing in the daily cash sheets purporting to identify withheld receipts do not conclusively prove that the amount

was actually withheld for the reason that these same records also contained additions to receipts which were arbitrarily added to the records reflecting daily cash receipts. Furthermore, the possibility that these entries were made by Webb and Goldstein, for the purpose of concealing a well designed plan of embezzlement should not be disregarded; inasmuch as these employees had complete control over the operations of the Decedent's businesses, it was a relatively simple matter, after the death of the Decedent, for these two individuals to claim that this income was withheld by the Decedent at his instructions and, by so doing, they themselves could disclaim the receipt of such income.

If their testimony is not false, one important question must, of necessity, persist throughout this proceeding, that is, where is the sum of \$131,000.00? Neither Respondent's agent nor the Executor or Administrator for Decedent have any knowledge of the whereabouts of this money; in all candor, it is submitted that no such sum ever existed.

By defining the unsubstantiated oral testimony as "specific items", the Court below has actually succumbed to every argument and claim advanced by Respondent and has, at the same time preemptorily disregarded the arguments and claims presented by Petitioner.

One of the principal arguments advanced by Petitioner in opposition to the matter of "specific items" and on which there is no discussion in the opinion of the Court below, involves the stipulation of the net worth; Petitioner argued that this fact precluded an attack on the net worth in the absence of discrepancies or duplications; inasmuch as stipulations constitute judicial admissions, there is no need for substantiation. Prior to its becoming a part of the stipulations, the net worth entailed considerable painstaking work and it was thoroughly examined by Respondent. The fact that this method has had judicial approval on numerous oc-

casions justified the adoption thereof by Petitioner in support of the proposition that the net worth method was the most reliable in the absence of adequate books and records in determining income. Due to Respondent's failure to present documentary corroboration of oral testimony, the determination of Decedent's income should be confined within the bounds of the net worth as presented.

**PART IV. THE AMOUNT BY WHICH INCOME WAS INCREASED  
IN EXCESS OF DECEDENT'S NET WORTH IS NOT, IN FACT,  
INCOME TO THE DECEDENT**

By increasing Decedent's income in excess of that resulting from the net worth method, the Court below could have done so only by characterizing the testimony of Webb and Goldstein as "credible, consistent, powerful and persuasive", coupled with the assumption that the so-called "withheld receipts" were not deposited in Decedent's bank account without actual proof that they were not so deposited. Upon reviewing the testimony of Webb and Goldstein, a serious question is raised as to whether their testimony is credible and consistent. A second serious question is raised when their private financial transactions in large sums are analyzed in relation to the alleged withheld receipts.

In commenting upon this aspect of this proceeding, it is considered advisable to set forth an analysis of the testimony of Respondent's witnesses:

**I. WITNESS: ROBERT WEBB**

**A. Illustrations of Self-Contradictions**

**(1) In Re: Envelopes in Which Alleged Withholding of Receipts Were Placed**

On one occasion, Webb testified that he used three envelopes in which the receipts, allegedly withheld from the French Cafe and the Southern Bar, were kept. One envelope, marked "Cafe", contained receipts of \$10.00 per day supposedly withheld from that business. The second enve-

lope, marked "Bar", contained receipts of \$25.00 per day allegedly withheld from the receipts of this operation. The third envelope contained the unusual amounts allegedly withheld on Saturdays, Sundays and holidays. R. 349-354 incl. On another occasion, he stated that four different envelopes were used. R. 349.

Note: An examination of the record fails to establish the actual use of four separate envelopes.

This witness stated that W. F. Rau, Sr., *never* touched the envelope containing the \$10.00 per day nor the one containing the \$25.00 per day. R. 350, 352. Webb never recalled an occasion on which the envelope was empty when he opened it at the end of the month. R. 349. He also said that he never saw Mr. Rau open either the \$10.00 or the \$25.00 envelope; that he himself took the money out of both of these envelopes. R. 338, 350, 354. At a subsequent time, he stated that there were occasions when there would be no cash left in either the \$10.00 or the \$25.00 envelope at the end of the month. His testimony verbatim was "I recall it, that would be all taken out". R. 353.

When Webb was questioned as to whether or not he wrote the words, "French Cafe", on the envelope when he put the cash in it, he stated, "Oh yes, yes, I did". R. 195. In response to a question previously asked as to how often he wrote "French Cafe" on the envelope, he replied, "Once". R. 154. On still another occasion, he was asked, "Now, when did you write 'French Cafe' on the envelope?" His answer was, "On the first time I put any money in there". R. 195.

With respect to the receipts that Webb placed in the envelopes, he testified that the receipts of the Southern Bar were brought to him by the bartender in the morning. R. 166. At a later time he testified that the receipts were left in the cash register by the bartender and that he (Webb) took them from the cash register along with the register

tapes. R. 169. Previously, on direct examination, this witness testified that *he* went to the cash register at the bar in the morning to get the receipts, tapes and tickets and that he then waited for Mr. Rau to come down stairs; that if Mr. Rau did not come down that morning, then he, Webb, took the receipts, tickets and tapes upstairs to Mr. Rau; that he put the \$25.00 in an envelope. R. 117. The only logical inference to be drawn from this testimony is that the placing of the \$25.00 in the envelope must have occurred in the morning. On still another occasion, Webb stated that he put the receipts from the bar and the cafe in an envelope at 4:00 P. M. R. 173.

The testimony of this witness as to the whereabouts of the receipts which he received at 7:00 a. m. from the French Cafe and the Southern Bar, until he placed the money in the envelopes at 4:00 p. m. is very vague and indefinite. Counsel for respondent endeavored to clarify this situation and it was then developed that the cash receipts received by Webb at 7:00 a. m., "laid there" until 4:00 p. m. R. 173-179 incl. When the Court interrogated Webb on this point, he failed to account for the whereabouts of the receipts from 7:00 a. m. until 4:00 p. m. The Court's understanding was that the entire receipts were deposited in the bank the following morning, but Webb's testimony is *contra*. R. 177-179 incl.

**(2) In Re: Daily Cash Sheets of the French Cafe (Exhibits 20 to 24 Inclusive)**

Webb had previously testified that the decedent was mentally "sharp" and "alert". R. 149. However, when he was questioned as to his reason for taking the daily sheets of the French Cafe up to Mr. Rau instead of the day books (Exhibits O, P, Q, R, S), reflecting the receipts of the French Cafe *as well as those for the Bar*, he said, "That would not give him a true picture of the receipts; the reason I didn't show him that." Along these same lines, the

following question was asked of Webb, "Wouldn't give him a true picture of the receipts?". Webb then answered, "No. If I showed him \$256.07, he wouldn't know what that meant". R. 368.

In analyzing this testimony, it must be remembered that the receipts of the Cafe and the Bar, as recorded in the day books (Exhibits O, P, Q, R, S), were identical to those appearing in the daily sheets of the French Cafe. In fact, the day books were employed by Rose Goldstein for recording the receipts of both operations. R. 422.

When Exhibit 20, the daily sheets of the French Cafe, was exhibited to Webb for the purpose of getting his explanation relative to the additions reflected thereon, he testified that the additions to the daily receipts were made for the purpose of making the deposits "look better". R. 297. According to him, the additions brought the deposits over \$300.00, and this, in turn, was the way in which the deposits were made to "look better". Mr. Webb repeated this as his explanation on several occasions. R. 297, 298.

When the daily sheet of the French Cafe for the date of Tuesday, September 21, 1943, was shown to Webb, he explained that the addition of \$61.30 to the receipts was done for the purpose of making the deposits in excess of \$300.00. The receipts themselves, however, amounted to \$354.38, exclusive of the addition of \$61.30. The total deposits on that date amounted to \$415.68.

A similar explanation was given by this witness when the daily sheet of the French Cafe for Wednesday, September 2, 1943, was shown to him. The receipts on that day amounted to \$308.13 without any adjustment in the form of additions to receipts. R. 313.

The daily sheet of the French Cafe for Friday, September 24, 1943, reflected receipts of \$306.10 exclusive of any adjustment with respect to additions or deductions. R. 314, 316-317.

The daily sheet of the French Cafe (Exhibit 20) Saturday, September 25, 1943, reflected receipts in the amount of \$483.90, less alleged deductions of \$110.00, resulting in a net amount to be deposited of \$373.90, to which was added the sum of \$27.20 resulting in net deposits of \$401.10. This amount is far in excess of the \$300.00 which Mr. Webb explained as the reason for the additions to the receipts of the French Cafe. R. 316, 317.

The daily sheet of the French Cafe for Monday, September 27, 1943, reflected receipts in the amount of \$332.76, from which was subtracted the sum of \$10.00, resulting in a total of \$322.78, to which was added the sum of \$32.15, resulting in a total deposit of \$354.93, which exceeds the \$300.00 which Mr. Webb stated was necessary in order to make the deposits "look better". R. 317.

On another occasion, Webb testified that Mr. Rau would state that he had too much money in his bank accounts and therefore instructed Webb to make withdrawals and to transfer the funds into another account or to deposit these funds in Mr. Rau's personal account. R. 265. When a check drawn by Webb in the amount of \$615.00 on January 4, 1945, part of Exhibit 18, was shown to him, he explained that the purpose of drawing this check was on instructions from Mr. Rau because, Mr. Rau said, he had too much money in his bank. At that time, the bank balance was \$20,759.79; Webb explained that the check in the amount of \$615.00 was drawn for the purpose of "cutting down the balance a little bit". R. 276. On the one hand, Webb explains that the additions reflected on the daily sheets of the French Cafe were entered for the purpose of making deposits "look better". This, of course, has the effect of *increasing* the bank balances. On the other hand, he has a contrary explanation with respect to the drawing of a check to cash to cut down a bank balance of more than \$20,700 by the mere sum of \$615.00.



**(3) In Re: Issuance of Checks**

The record clearly establishes that Webb had the authority to draw checks on the bank accounts of the Southern Hotel and the Southern Bar maintained in the Bank of America and, that he had a like authority to draw checks on the bank account of the French Cafe maintained in the Anglo California Bank. R. 179, 235.

According to him, the expenses at the French Cafe were paid by cash except for an order amounting to \$100 to \$150 or \$200. R. 180. He further stated that everything for the Southern Wine and Liquor Bar was paid for by check. The exceptions included such things as ice, limes, oranges or incidentals. R. 180. When he was questioned as to whether he actually did the buying for the French Cafe, Webb stated that he thought that there was one check on the French Cafe in the amount of \$3,500.00 that was made payable to him that he evidently cashed. R. 181.

Subsequently, he stated that he spent very little time in the Cafe. In fact, he said that he didn't have anything to do with the Cafe; and, as to the operation of the Bar, he would "go back and forth" but there were no special hours or duties performed by him at the Bar. The Court's understanding of this witness' testimony, with respect to the operations of the Cafe, was that he had nothing to do with that business apart from "receiving cash." In answer to that statement of the Court, Webb answered, "Yes sir, your Honor". R. 294. At a later time, a total of 596 checks issued by Mr. Webb in connection with the payment of operating expenses of the French Cafe, including payroll, for the years 1944, 1945, and 1946, were shown to him; this, of course, is not just "receiving cash". Previously, he had stated, "I didn't do any buying in the French Cafe". R. 155.

According to his testimony, Webb did the buying for the Southern Bar for a period of one and a half to two years, or during 1945 and 1946, until the bar was closed. R. 154,

155. At this point, 157 checks, representing purchases for the Southern Bar for the calendar year 1944, bearing the signature of Mr. Webb, were exhibited to him. All of these checks were payable to cash. R. 154, 155. It was here, that Mr. Webb stated that there was no buying in the form of cash at the bar. According to him, all purchases were made by check. R. 155. Subsequently, however, he testified that the payouts for the Southern Bar were practically all by check except for ice and incidentals. R. 371. On two separate occasions, Webb stated that, in making the checks out for the expenses at the bar, he drew the checks payable to the *supplier*. R. 371. When the 157 checks drawn on the bank account of the Southern Bar for the calendar year 1944 were shown to Mr. Webb, he admitted that all of them were payable to *cash*. R. 372. As to this, Webb stated that he could explain the purpose for which the checks were drawn if he could look at the check stubs. R. 372. When the check stubs (Exhibit 26) were shown to him, however, the only notation appearing thereon was that of "supplies". R. 373, 374.

Webb had consistently testified that receipts were being withheld from the French Cafe and the Southern Bar each day in the week in the respective amounts of \$10.00 and \$25.00 and that larger amounts were withheld from these operations on Saturdays, Sundays and holidays. When he was called upon for an explanation as to the purpose of drawing checks to cash in view of the fact that he was withholding receipts in the amounts already testified to, his explanations were very vague and indefinite. R. 270-276.

Webb had previously testified that Mr. Rau moved from the Southern Hotel in the latter part of 1945 and that he thereafter lived in his home on Brighton Way. He also stated that Mr. Rau would come back to the hotel, nearly every day, except when Mr. Rau was away on a vacation. When he was interrogated with respect to whether or not he first obtained permission from Mr. Rau every time he

drew a check on the business bank accounts, he stated, "Absolutely". On another occasion, he testified that there never was any exception to this practice. R. 266. He further stated, that Mr. Rau was "right there", otherwise he (Webb) could not make the check out. R. 264. It is apparent, therefore, on those occasions when Mr. Rau did come to the hotel, or when he was away on his vacation, that he could not give Webb permission to draw checks, nor could Mr. Rau be "right there". On one occasion, Webb denied that he was a partner in the operation of the French Cafe at the time certain checks were drawn on the bank account of that enterprise. R. 334. Subsequently, however, he admitted that his signature appeared as drawer on check No. 1290 dated June 19, 1947, at which time he was a partner in the operation of the French Cafe with Mr. W. F. Rau, Sr. and Mr. Phil Bender. R. 335.

**(4) In Re: Physical Condition of Mr. W. F. Rau, Sr.**

Webb testified that Mr. Rau's physical condition was good up until the last two years, namely 1946 and 1947. R. 149, 150. He also stated, however, that Mr. Rau had a lot of trouble with his legs and that he used a cane. R. 151. On another occasion, he stated that Mr. Rau "got around very fast in the hotel; he could walk as good as anybody". R. 183. At still a later time, this witness stated that "he (Rau) wasn't a well man". R. 184. At another time, Webb said of Mr. Rau, "but he didn't like to go out on the street; when he went outside he usually got in the car and he would drive". R. 183-184.

**(6) In Re: Other Instances of Self-Contradictions**

On direct examination (Exhibit N), the day book for 1944 was shown to Mr. Webb and he answered that the entry under date of Sunday, February 6, 1938, was in his handwriting. R. 107-108.

Webb testified that the receipts from the Bar were withheld at the rate of \$25.00 per day and that on Saturdays,

Sundays and holidays, they were understated from \$100.00 to \$200.00 each day. This testimony was repeated by Webb on several occasions. R. 135, 136.

On direct examination, he stated that he could not swear that \$100.00 on Saturdays, Sundays and holidays was withheld from the receipts of the Southern Bar in 1942. When the Court interrogated Webb along these lines, he stated that the practice of taking \$100.00 a day for Saturdays, Sundays and holidays from the receipts of the Southern Bar began a few months after Pearl Harbor, or December 7, 1941. R. 137. Further interrogation in this connection resulted in testimony that the practice of taking more than \$25.00 per day from the Southern Bar commenced in the latter part of 1942. R. 137-138. When Webb was confronted with the inconsistency in his testimony, he attempted to explain that he thought the questions related to the operations of the French Cafe, which, it should be remembered, involved the alleged taking at the rate of \$10.00 per day from receipts and had nothing to do with the taking of \$25.00 per day from that operation. R. 137, 138. Subsequently, this witness stated that the practice of taking \$25.00 a day from the receipts of the Southern Bar began in the first part of 1942. R. 138, 139.

When Webb was questioned as to the number of hours per day that Rose Goldstein devoted to keeping the books for the decedent, he stated that there wasn't any set time. He further stated that she might work all evening, "maybe half a night, sometimes, all depended on how busy we were". When he was asked how he knew that Rose Goldstein worked half the night, he replied as follows, "Well, I was in there plenty of times during the night and seen her in there." When he was interrogated as to his coming to the hotel at night time, after working from 7 A. M. until 7 P. M., he stated, "I might come in the bar and have a drink, or see some friends and do most anything". When he was asked if he would stay later than 12 o'clock at night

at the bar, he replied by saying, "Sure". R. 160. When he was asked whether or not, on the occasions he returned to the bar at night time, he bought whisky for his friends, he stated, "No, very rarely I would buy any drinks. I thought I was entitled to drink on the house". When he was further asked as to whether or not he meant the drinks were "on Mr. Rau", he replied, "That is right". He further stated, "I had many drinks." A little later on, Webb stated, "And as far as going up there (at the bar), I didn't go up there too often, because I worked till 7 o'clock, and at night, and I couldn't stand it; when you work from seven to seven, you're not going to do too much running around". R. 208, 209. When it served the purpose of this witness, he testified, on one occasion, that he was in the hotel and bar "plenty of times". This was his testimony in order to support the work of Rose Goldstein with respect to her duties at the hotel when he was off duty as well as the work which she performed in keeping the books. However, when it develops that he is taking advantage of Mr. Rau in the evenings, not only from the standpoint of taking his meals at the hotel but also drinking whisky at the bar, he then states that as far as going up to the hotel or the bar was concerned he didn't go up there very often.

When Webb was interrogated concerning the proceeds of a check dated May 2, 1947 in the amount of \$1,200.00 drawn by him on the Anglo California National Bank, Bakersfield, California, and endorsed by him as "W. F. Rau, Sr.", he stated that such proceeds were deposited by him in his personal bank account at the Bank of America on May 27, 1947. R. 243. When, however, the Court directed Webb's attention to the fact that the deposit of \$1,200.00 in his personal bank account was twenty-five days subsequent to the date on which the check was drawn, he then stated, "Well, that is a different deal then". R. 245.

On one occasion, Webb testified that the cancelled checks and the bank statements went to Rose Goldstein when they

were returned from the bank. R. 249. He also stated that the cancelled checks and bank statements were kept in the front desk drawer at the hotel. R. 250. The only fair interpretation of this testimony, is that the cancelled checks and the bank statements, if they went to Rose Goldstein, were presumably kept in her desk at the lobby. If that is true, Mr. Rau did not see the bank statements or the cancelled checks for the simple reason that he never went to Rose Goldstein's desk, as stated by Webb on a previous occasion.

It is well to review the testimony of Mr. Webb relative to a transaction involving the issuance of a check in the amount of \$3,500.00. This particular check according to Webb, related to the purchase of a home by Mr. W. F. Rau, Sr., located at 318 F Street, Bakersfield, California, in 1942. This check was drawn by Robert Webb on the bank account of the French Cafe and was payable to cash, or to Robert Webb. Webb places the date of this transaction in 1942. He did so on two occasions; he was able to substantiate this date because, as he stated, "It finally dawned on me, because I lived in the house for five years, and it was 1942 before the real estate prices went up. That is, I know he got this, he bought the house right then, and Mr. Mongerson wanted to get out of town, as fast as he could." R. 181-183 incl. The stipulations of fact reflect that the house, referred to by Webb, located at 318 F Street, had been purchased at least by 1941. Webb stated that he was unable to give an explanation for this transaction to the Revenue Agents when he was interrogated by them in 1949 but that now, in 1958, he was able to recall it. R. 181.

According to Webb, the French Cafe opened for business sometimes at 7 A. M. and, at other times, at 10 or 11 A. M. R. 166. Presumably, he makes this statement in view of the fact that he had already testified that his hours were from 10 A. M. to 5 P. M. after 1945 or 1946. He had previously stated that the steward of the French Cafe gave him the

cash receipts of that business at 7 A. M. each morning. This testimony had been consistently given by Webb as demonstrated by the record. R. 164-179 incl. Even a cursory examination of Webb's testimony in this connection, leads to the conclusion that he was endeavoring, throughout his testimony, to protect himself at all times. Specifically, Webb would have the Court believe that he received the receipts of the French Cafe directly from the steward and that only that which the steward gave to him was what he had in his possession. In order to accomplish this, it was necessary for Webb to state that the French Cafe did not open for business until 10 or 11 o'clock in the morning after he changed his starting hours from 7 A. M. to 10 or 11 o'clock in the morning.

## **B. Contradictions by Other Witnesses**

### **(1) By Rose Goldstein**

Rose Goldstein testified that both W. F. Rau, Sr., and *Mr. Webb* instructed her to make the entries in the cash journal. R. 435. According to Webb, however, he knew nothing about the books, and as a matter of fact, he stated, "Didn't look at them". "I did not understand them." R. 260.

This witness also testified that there were no cash payouts at the Southern Bar. R. 444. In this connection, Webb stated that there were cash payouts for such things as limes, ice and incidentals. R. 371.

### **(2) By Mrs. Betty Dorsey**

Webb had testified that he took the daily sheets of the French Cafe up to Mr. Rau along with the cash register tapes as well as the tickets, and that he left the cash register tapes in Mr. Rau's room. R. 369-370. Mrs. Betty Dorsey, however, testified that she never saw Mr. Webb bring any books or records or cash register tapes up to Mr. Rau while she was employed as his nurse from the latter part of 1945

up until the date of Mr. Rau's death in January, 1953. R. 543, 553-557.

Webb had testified that Mr. Rau was mentally "sharp". R. 149. According to Mrs. Dorsey, Mr. Rau was not mentally alert at all times, nor was he quick and alert in his responses to questions. R. 543-544. In fact, Mr. Rau was subject to spells of weeping and crying when she first began her employment with him. R. 544.

Webb had testified that Mr. Rau usually carried pretty large sums of money in his pockets at all times. R. 197. Mrs. Dorsey refutes this testimony when she states that on the occasions that she emptied Mr. Rau's pockets, before sending his suits to the cleaners, she never saw any large sums of cash. R. 545.

Webb stated that he took the cash receipts together with cash register tapes and tickets up to Mr. Rau in his room when Mr. Rau did not come downstairs. R. 117. He also stated that he left the cash register tapes in Mr. Rau's room. R. 370. Mrs. Dorsey testified that there were no records or cash register tapes in Mr. Rau's room while she was employed as his nurse. R. 543.

On several occasions, Webb testified that Mr. Rau was "right there" every time he drew a check on any business operation. He reaffirmed this by repeating that Mr. Rau was always there and there were never any exceptions. According to Mrs. Dorsey, Mr. Rau was confined to his bed for a period of at least three weeks in the latter part of 1945 and that at no time did anyone ever bring any books and records of any kind up to Mr. Rau, nor did she see him make any entries in any of these books and records, which, of course, must be interpreted to include the signing of checks by Webb. R. 542-544 incl.

Webb had testified that up until 1946 and 1947, Mr. Rau's physical condition was "good", but Mrs. Dorsey testified



that Mr. Rau was unable to dress himself when she began her employment with him in the latter part of 1945. R. 545.

Webb testified that he was at the bank at 10 o'clock every morning, making deposits and doing other banking transactions, including the cashing of checks. According to Mrs. Dorsey, she never took Mr. Rau to the hotel, after they had moved to his home until around 11 o'clock in the morning. This, of course, can only mean that many banking transactions, involving the cashing of checks and the depositing of cash, occurred prior to the time that Mr. Rau arrived at the hotel. R. 563. Furthermore, Mrs. Dorsey stated that, although they went to the hotel quite often, they did not go every day. R. 563.

According to Webb, Mr. Rau knew about everything, including every transaction, in connection with the operation of the businesses. Mrs. Dorsey, however, testified that Mr. Rau did not seem to have any interest in his businesses for the reason that he spent most of his time in his room and, after moving from the hotel, spent most of his time at home. R. 543, 547, 553-554, 555-556, 558, 559, 562.

## II. WITNESS: ROSE GOLDSTEIN

### A. Illustrations in Self-Contradictions

#### (1) In Re: Bookkeeping Duties

Rose Goldstein had testified that she devoted very little of her time to the keeping of the books and records for the decedent because, as she had stated, she spent most of her time in her other businesses. R. 504. She elaborated somewhat on this and stated that, "the only book work I did, was post the checks, which didn't take me long". R. 504. The record establishes that this witness made entries on the daily sheets of the French Cafe when Mr. Webb was either absent or was not there on Sunday. She recorded the receipts of this operation. R. 422, 423-424. This witness also maintained the ledger and made the entries therein. Miss Goldstein also recorded cash purchases. R. 427. In addi-

tion to these, she made out the deposit tickets when Mr. Webb was away and then saved them until he returned. R. 491. She kept the books and records for the decedent from 1936 up until the termination dates of the various businesses as indicated in the record. R. 419. It is also an undisputed fact that she worked at least two hours each day while Webb took a nap from 12 o'clock noon until 2 P. M.; and that she relieved Webb for two hours on Sunday and that she worked all day on the following Sunday; that she worked on Saturdays, Sundays and holidays, performing, on those days, the duties customarily performed by Webb. Such work, of course, involved the handling of cash receipts of the Southern Hotel, French Cafe and the Southern Bar. In registering guests at the hotel, she must have made the necessary entries in the records of that business. Entire record.

**(2) In Re: Cash Receipts of the French Cafe and the Southern Bar**

On one occasion this witness testified that she gave the cash receipts of the French Cafe and the Southern Bar to Mr. Rau during Webb's absence. R. 481. She had previously testified that she placed the cash receipts from these operations in an envelope until Mr. Webb returned on Monday, at which time she gave the envelope to him. R. 446-447. Subsequently, Goldstein stated that the receipts of the French Cafe were placed in a cigar box and that she removed them for the purpose of counting the money for Mr. Rau; that she had left the money on the counter for Mr. Rau, but refused to state whether or not she personally gave the money to him. R. 488, 489.

**B. Contradictions by Other Witnesses**

**(1) By Walter Slater**

Rose Goldstein stated that she was unable to recall an examination of Mr. Rau's income tax returns for the taxable years 1942, 1943 and 1944. R. 492. She was likewise unable to recall Mr. Walter Slater, the Revenue Agent who

made the examination. R. 491. In view of Goldstein's inability to recall that such an examination was conducted or the Agent who performed it, the fact that Revenue Agent Slater testified that his examination extended over a period of four or five days, and that he consulted with Goldstein regarding the books and records, has the effect, in substance, if not in form, of contradicting Goldstein in this regard. Slater also testified that, in his opinion, Goldstein was not cooperative. R. 574, 575. According to Slater, he performed his examination at the Southern Hotel and he had several discussions with Goldstein during his investigation. R. 574, 575.

Goldstein had corroborated Webb's testimony to the effect that the deductions entered on the daily sheets of the French Cafe were made each day, commencing with 1942 until July 6, 1946. Slater testified that at the time of his examination, in the latter part of 1946, he did not recall seeing either the daily sheets of the French Cafe or any entries of deductions reflected thereon. (Exhibits 20, 21, 22, 23, 24). R. 576.

Slater examined the ledger and cash journal receipts and disbursements in which Goldstein recorded all purchases for the various operations. Slater did not discover false entries or other evidence of fraud in these records. R. 580. According to Goldstein, the purchases for 1944 were overstated. R. 427-431 incl.

Relative to the private transactions of Respondent's witnesses, Petitioner was limited to deposits in their respective checking accounts exclusive of sums contained in their safe deposit boxes and amounts in their savings accounts. Although the Court below commented upon the deposits made by Webb and Goldstein in their bank accounts, it merely accepted their testimony as a justification for these large transactions; presumably, the Court observed no significance in other evidence bearing a close relationship to the deposits appearing in Webb's bank account as set forth in

the Court's opinion (R. 62). Specifically, this evidence is Exhibit 14, consisting of five checks drawn by Webb during the period of time he was preparing to enter into a partnership with the Decedent. The checks in question were drawn by Robert Webb, payable to W. F. Rau, Sr., on Mr. Rau's checking account; the name of W. F. Rau, Sr., was actually endorsed by Webb who received the proceeds thereof; Exhibit 14 consists of the following checks in the amounts and on the dates as indicated:

<u>DATE</u>	<u>CHECK NO.</u>	<u>AMOUNT OF CHECK</u>
April 7, 1947	753	\$1,000.00
May 2, 1947	806	1,000.00
July 7, 1947	917	3,500.00
June 3, 1946	10	600.00
November 1, 1946	319	1,200.00
		<hr/>
Total:		\$7,300.00

The unusual deposits to Webb's bank account during this period are tabulated as follows (R. 62):

<u>DATE</u>	<u>AMOUNT</u>
May 27, 1947	\$1,200.00
May 29, 1947	916.83
May 29, 1947	3,600.00
June 2, 1947	5,000.00
June 13, 1947	1,000.00

In Petitioner's view, the Court's explanation for the source of the deposits in Webb's bank accounts is lacking in realism and fails to take into account the evidence represented by Exhibit 14. If it is assumed that Webb had accumulated savings to the extent accepted by the Tax Court, and was planning to form a partnership requiring the contribution of \$12,000.00, it is most peculiar that he would make five different deposits to his checking account and that he, at the same time, would draw checks on his employer's bank account and endorse the name of his employer and obtain the proceeds during the same months preceding the

formation of the partnership; the most damaging aspect of this testimony is that Respondent was unable to establish that the proceeds of the checks, so endorsed by Mr. Webb, were ever returned to the bank account of the Decedent. It is Petitioner's contention that the circumstances are not to be casually considered and then casually ignored; at least, Petitioner has demonstrated by positive, direct evidence the receipt of funds by Webb from the business bank account of his employer and has presented most cogent evidence that these same funds were subsequently deposited in the bank account of Webb. The Court below accepted far less credible evidence by accepting mere oral testimony of the very same witnesses whose private affairs are clothed with suspicion.

Relative to the bank deposits of Rose Goldstein, the Court below again disposed of this aspect by simply stating that such deposits represented income derived from her business; in its opinion, the Court below referred to such deposits and set forth a schedule reflecting some of these deposits on various dates from 1943 to 1947 (R. 63); the Court, however, failed to make any comment with respect to the deposits appearing under date of January 31, 1946, April 2, 1946 and May 9, 1946, in the respective amounts of \$3,642.88, \$1,000.00 and \$1,150.00 (Note: These deposits are illustrative of Goldstein's testimony and do not exclude other deposits about which she testified). Goldstein testified that these particular sums represented receipts which she received from the preparation of income tax returns (R. 519). This testimony should be subjected to more than a cursory examination for this reason: in order to justify the deposit of \$3,642.88 on the 31st day of January, 1946, Goldstein's fees for preparing income tax returns must have been enormous, or she must have prepared hundreds of returns at nominal charges; assuming that she received as much as \$25.00 per return, it would have been necessary for her to prepare not less than 145 separate returns during

the month of January, 1946. According to her, she assisted Webb in his duties during the day as well as in the evenings (R. 473); the time remaining for her to discuss the returns with her clients and to assemble the information, excluding the computation of tax for 145 returns would exceed the hours available in each day for thirty consecutive days; it is submitted that her explanation for the source of such a large sum is unworthy of belief.

Having predicated its findings on inconsistent and contradictory testimony relating to alleged withheld receipts, envelopes, drawing of checks, payments in cash, depositing of funds, removing of cash from cash registers and the location of cash, the decision of the Court below is clearly erroneous and constitutes an arbitrary and capricious determination of Decedent's taxable income.

In making its determination, the Court below unhesitatingly adopted and approved the testimony of Respondent's witnesses, rejected the net worth, explained away highly questionable personal banking transactions of Respondent's witnesses, rejected the testimony of Decedent's witnesses as to which there is no evidence of a contradiction or an inconsistency. This, it is submitted, results in an improper and injudicious determination of the income tax liabilities of Petitioner's Decedent.

#### PART V. FRAUD

The real issue in this proceeding involves, of course, the question of fraud. The principle that fraud is never presumed, and that it must be established by "clear and convincing evidence" has long been recognized by this Court as well as others, in which this issue has been adjudicated.

It has also been held that, a deficiency in taxes, in, and of itself, is not sufficient for the purpose of sustaining the penalty under Section 293 (b), I.R.C. 1939. *Henry S. Kerbaugh*, 29 B. T. A. 1014, Aff'd. 74 Fed. 2d. 749, C. A. 1

(1935). In that case the Board of Tax Appeals refused to impose the fraud penalty, and, on that issue, Judge Van Fossan had this to say: "A charge of fraud has always been a serious matter in the law. Not only is it never presumed but the ordinary preponderance of evidence is not sufficient to establish such a charge. It must be proved by clear, convincing evidence." This principle finds support in the case of *Nicholson v. Commissioner*, 32 B. T. A. 977 (1935) Aff'd. 90 Fed. 2d 978. Notwithstanding the fact that the Petitioner, in that case, reported net income of \$40,424.66, when, in fact, it was \$73,435.38 for the year 1939, the Board of Appeals, in refusing to sustain the fraud penalty, said, that the deficiency, by itself, does not establish fraud. The Board also said, "If it did, then all taxpayers against whom deficiencies are determined would be guilty of fraud and subject to the imposition of the fraud penalty." It has also been held that "mere suspicion" is insufficient for the purpose of establishing fraud. This principle has been recognized in the law, not only as it relates to taxes, but in other fields as well. It was expressed by the Board of Tax Appeals in *William J. Schultze*, 18 B. T. A. 444 (1929). In that case, the Petitioner derived illegal income from bootlegging during the year 1920-1924. Despite the failure of the Petitioner to appear at the hearing, the Board of Tax Appeals rejected the fraud penalty and, in so doing, stated, "We may entertain whatever suspicions we choose, or infer whatever probabilities our imagination dictates, but to find a man guilty of fraud requires more than suspicion or mere probabilities of dereliction. . . .". Other decisions to the same effect are, *Sharpsville Boiler Works Co.*, 3 B. T. A. 568 (1925); *Arthur M. Godwin*, 34 B. T. A. 485 (1936); *Arthur S. Barnes*, 36 B. T. A. 764 (1937); *Nicholas Boerich*, 38 B. T. A. 567 (1938) Aff'd. 115 Fed. 2d. 39 (C A. D. C. 1940) cert denied, 312 U. S. 700 (1941); *L. Schepp Co.*, 25 B. T. A. 419 (1932).

It is well, at this time, to refer to the case of *Wiseley v. Commissioner*, 185 Fed. 2d. 263, decided by the Circuit Court of Appeals for the Sixth Circuit, reversing 13 T. C. 253. In that case, the Petitioner, a practicing physician, undoubtedly possessing a high degree of learning, maintained daily records of his income during the years 1942 to 1945 inclusive. Despite this, however, he reported approximately one-sixth of his actual income as established by his *net worth*. In reversing the Tax Court on the issue of fraud, the Court of Appeals attached considerable importance to the Petitioner's explanation that he was extremely busy during the war years and that he was under much strain in practicing his profession. Although this explanation was a self-serving one, the Court of Appeals was of the opinion that it was of sufficient weight to negate the charge of fraud.

In the present proceeding, the taxpayer was deceased and therefore unable to offer any explanation in refutation of the charge of fraud. That fact, it is submitted, deserves more than token consideration. The Tax Court has held that, although a Petitioner's explanation was inadequate, or even contradictory, such fact is not sufficient for sustaining Respondent's burden of proof on the issue of fraud; *Thomas Ferrara*, T. C. Memo Decision, 1-31-51, Docket No. 23274. To uphold such a charge under the circumstances prevailing herein would be tantamount to finding Mr. Rau guilty of a serious offense, by a hearing which would not be far removed from one in the nature of an *ex parte* proceeding. The fact that the Administrator of the Estate opposed the claim and exercised his right of cross examination, is of little comfort under such circumstances. The representatives of the Estate of Mr. Rau were denied the benefits of his testimony and, as the record shows, were confronted with such statements as "Mr. Rau instructed me", or "Mr. Rau was right there", or Mr. Rau "knew everything".

In the judicial concept, fairness connotes equal treatment. As such, it is the very basis upon which our system



of jurisprudence is founded. Is it fair, therefore, to find Mr. Rau guilty of fraud by reason of the fact that he was unable to defend himself against such charges? Is it fair that the income of the Decedent, as well as the disposition of his Estate, should be determined by accepting the mere utterances of such phrases as, "I was instructed", etc.? Who can now refute or contradict these patently self-serving declarations?

The evidence indicating the withholding of receipts may be assailed by referring to the testimony of Webb; according to him, the daily cash sheets of the French Cafe contained a total figure that was used as the receipts for each day; included in the grand total was an amount which had been arbitrarily added to the total amount which was then deposited in Decedent's bank accounts (R. 297, Line 23); Webb further testified that there were many occasions on which there were no deductions from or withholding of receipts (R. 296-311); again, Webb stated that he was instructed to make additions so as to make the deposits "look better by bringing them over \$300.00" (R. 297-298).

The testimony of Webb relating to the entries appearing on the daily cash sheets is not clear and convincing for the purpose of establishing the withholding of receipts in the amount as determined by the Court below; there is considerable doubt that such bookkeeping gyrations actually accomplished any such withholding. It will be noted that these same records reflected arbitrary additions to income and that the amount of the deposits were used as receipts for each day. The fact that checks were issued to cash purporting to represent purchases of supplies does not justify the conclusion that receipts were withheld. Although purchases may have been duplicated to the extent that the checks did not, in fact, represent purchases, it should not be construed as withholding of receipts. In addition thereto, the issuance of checks to cash could have been a device employed by Webb and Goldstein in siphoning off funds be-

longing to their employer; unless Mr. Rau examined every invoice for which such checks were drawn, this method would escape detection. When consideration is given to these facts and circumstances, such a plan is not beyond the realm of possibility. While Petitioner has presented direct evidence as to the probable disposition of Decedent's funds, there is no duty upon Petitioner to "burn the house" in order to refute the method resorted to by Respondent in increasing Decedent's income in excess of that resulting from the net worth method.

### CONCLUSION

It is respectfully prayed that the decision of the Tax Court be set aside; that the case be remanded with instructions to afford Petitioner the remedies provided by law; that the Tax Court be instructed to order the production of all records, including the income tax returns, savings accounts, contents of and record of entries into safe deposit boxes, real estate, stocks and bonds, loans and related data of Robert R. Webb and Rose Goldstein, in their names, or others acting as their agents, for each of the years 1942-1947 inclusive; that the fraud penalty be removed from all the years in question; and, that the Tax Court be directed to reach a decision based upon the law and the evidence.

ELLSWORTH T. SIMPSON

*Attorney for Petitioner on Review*  
1029-33 Investment Building  
Washington 5, D. C.

*Of Counsel:*

THOMAS H. WERDEL, Esquire  
Bakersfield, California

## APPENDIX

## Statutes Involved

Section 7442, Internal Revenue Code, 1954, *Jurisdiction*:

“The Tax Court and its divisions shall have jurisdiction as is conferred on them by this title, by chapters 1, 2, 3, and 4 of the Internal Revenue Code of 1939, by title II and title III of the Revenue Act of 1926 (44 Stat. 10-87), or by laws enacted subsequent to February 26, 1926.”

Section 7482, Internal Revenue Code, 1954, *Courts of Review*:

“(a) Jurisdiction.—The United States Court of Appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in Section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in Section 1254 of Title 28 of the United States Code.”

Section 7483, Internal Revenue Code, 1954, *Petition for Review*:

“The decision of the Tax Court may be reviewed by a United States Court of Appeals as provided in Section 7482 if a petition for such review is filed by either the Secretary (or his delegate) or the taxpayer within 3 months after the decision is rendered. If, however, a petition for such review is so filed by one party to the proceeding, a petition for review of the decision of the Tax Court may be filed by any other party to the proceeding within 4 months after such decision is rendered.”

Section 1112, Internal Revenue Code, 1939, *Burden of Proof in Fraud Cases*:

“In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Commissioner.”

Section 293(b), Internal Revenue Code, 1939, *Additions to Tax in Case of Deficiency*:

“If any part of any deficiency is due to fraud with intent to evade tax, then fifty per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected and paid in lieu of the fifty per centum addition to the tax provided in Section 3612(d)(2).”

Section 145(b), Internal Revenue Code, 1939, *Failure to Collect and Pay over Tax, or Attempt to Defeat or Evade Tax*:

“Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than \$10,000.00, or imprisoned for not more than five years, or both, together with the costs of prosecution.”

Section 2404, Title 28, U. S. Code:

“A civil action for damages commenced by or on behalf of the United States or in which it is interested shall not abate on the death of a defendant but shall survive and be enforceable against his estate as well as against surviving defendants.” June 25, 1948.

## Exhibit 1—A

	As of 12/31/41	As of 12/31/42	As of 12/31/43	As of 12/31/44	As of 12/31/45	As of 12/31/46	As of 12/31/47
CASH:							
Bank of America, Bakersfield							
1. Southern Hotel	495.80	891.30	2,567.53	8,925.83	8,919.53	6,667.32	
2. Southern Wine & Liquor Store	789.75	4,512.62	17,419.68	8,932.06	20,520.55	2,489.39	
3. French Cafe	1,315.04	2,239.39	13,790.64	8,034.16	11,099.28		
4. W. A. Rau, Sr., Personal	4,366.01	5,096.20	4,440.81	2,278.23	4,261.84	2,931.57	9,458.18
5. W. A. Rau, Sr., Savings							50,000.00
Security 1st Nat'l. Bank, Ocean Park Branch, Venice							
6. Sea Spray Courts			841.50	2,155.24	4,251.36	1,559.53	3,285.77
7. Edmund Hotel				4,815.98	16,989.57	2,922.66	2,727.94
Bank of America, Taft							
8. Taft Hotel						1,636.76	
Anglo California Nat'l. Bank, Bakersfield							
9. W. A. Rau, Sr., Personal			3,823.28	831.58	2,345.78	27,723.28	
10. French Cafe, Partnership Interest							22,000.00
REAL ESTATE:							
11. Edmund Hotel, Venice—Land, Bldg. & Furnishings				91,500.00	91,500.00	91,500.00	91,500.00
12. Frame Building, 318 F Street, Bakersfield	4,660.00	4,660.00	4,660.00	4,660.00	4,660.00	4,660.00	4,660.00
13. 2 Frame Buildings, 34 and 34½ Sunset, Venice	8,332.30	8,332.30	8,332.30	8,332.30	8,332.30	8,332.30	
14. Sea Spray Courts, Venice		25,000.00	25,000.00	25,000.00	25,000.00	25,000.00	25,000.00
15. Dwellings, 133 Brighton Way, Bakersfield					10,500.00	10,500.00	10,500.00
16. Dwellings, 521 Ocean Front, Venice			7,000.00	7,000.00	7,000.00	7,000.00	7,000.00
17. Lot 171 S. E. ½ 172, Culver City	4,000.00	4,000.00	4,000.00	4,000.00	4,000.00	4,000.00	4,000.00
18. 15 acres Kern Co., California	750.00	750.00	750.00	750.00	750.00	750.00	750.00
19. Taft Hotel, Taft, California						70,000.00	
20. Mineral Rights, Norfolk, Virginia	50.00	50.00	50.00	50.00	50.00	50.00	50.00
21. Mineral Rights, San Luis Obispo Co., California	100.00	100.00	100.00	100.00	100.00	100.00	100.00
22. Buick Auto							2,357.99
23. Crypt, Bakersfield		760.00	760.00	760.00	760.00	760.00	760.00
24. Southern Hotel, F. & F.	8,600.00	8,600.00	8,600.00	8,600.00	8,600.00	8,600.00	
25. Southern Wine & Liquor Store, F. & F.	8,250.00	8,250.00	8,250.00	8,250.00	16,687.12	16,687.12	
26. French Cafe (Proprietorship)	8,250.00	8,250.00	8,250.00	8,250.00	8,250.00		
Total Assets	49,958.90	81,491.81	118,635.74	203,225.38	254,597.33	293,829.93	234,149.88



## Exhibit 1—A (Continued)

LIABILITIES	As of 12/31/41	As of 12/31/42	As of 12/31/43	As of 12/31/44	As of 12/31/45	As of 12/31/46	As of 12/31/47
<b>MORTGAGES PAYABLE:</b>							
27. 318 F Street, Bakersfield, California	1,093.30						
28. 133 Brighton Way, Bakersfield, California					7,117.44	6,277.44	
29. Taft Hotel, Taft, California						13,793.92	
30. Edmund Hotel, Venice, California				32,462.09			
31. 2 Frame Buildings, 34 & 34½ Sunset, Venice, California	4,233.28	1,562.21					
32. Sea Spray Courts, Venice, California		22,633.43	22,633.43				
<b>DEPRECIATION:</b>							
33. Taft Hotel, Taft, California						1,449.94	
34. Edmund Hotel, Venice, California				1,668.63	5,005.97	8,343.31	11,680.65
35. Sea Spray Courts, Venice, California		662.40	1,545.60	2,428.80	3,312.00	4,195.20	5,078.40
36. 2 Frame Dwellings, Venice, California	3,471.00	3,846.00	4,221.00	4,596.00	4,971.00	5,346.00	
37. Southern Hotel, Bakersfield, California, F. & F.	8,600.00	8,600.00	8,600.00	8,600.00	8,600.00	8,600.00	
38. Frame Building, Bakersfield, California	382.77	607.40	805.29	1,123.17	1,347.80	1,572.43	1,797.06
39. Southern Wine & Liquor Store & Bar, Bakersfield, California, F. & F.	5,775.00	6,600.00	7,425.00	8,250.00	8,531.24	9,374.95	
40. French Cafe	8,250.00	8,250.00	8,250.00	8,250.00	8,250.00		
Total Liabilities and Depreciation	31,805.35	52,761.44	53,480.32	67,378.67	47,135.45	59,003.19	19,356.11
Net Worth	18,153.55	28,730.37	65,155.22	135,913.20	207,508.89	234,933.25	215,660.28
Net Worth Increase		10,576.82	36,424.85	70,757.98	71,595.69	27,424.36	(19,272.97)
<b>Add:</b>							
Federal Income Taxes Paid		345.06	6,254.03	6,995.32	27,638.93	51,708.95	50,171.67
Living Expenses		3,665.76	3,553.32	3,793.81	3,620.22	3,969.03	4,702.73
Long Term Capital Loss							(2,779.02)
Capital Loss (Partnership)							(2,141.14)
Adjusted Net Worth Income		14,587.64	46,232.20	81,547.11	102,854.84	83,102.34	30,681.27
Income Reported—Including Prior Adjustments		10,680.46	38,707.31	41,342.64	45,459.76	89,560.84	32,435.39
Additional Net Income on Net Worth Basis		3,907.18	7,524.89	40,204.47	57,395.08	(6,458.50)	(1,754.12)

